NORTH CAROLINA

OFFICE OF THE TREASURER

JANET COWELL, TREASURER

November 30, 2012

Representative Julia Howard
North Carolina House of Representatives
16 West Jones Street, Room 1106
Raleigh, NC 27601

Dear Rep. Howard,

I write to offer my perspective and opinion on the best method to retire the $2.5 to $3 billion owed to the Federal Unemployment Insurance Trust Fund. I recognize that businesses are facing a significant financial burden as a result of the scheduled increases in federal unemployment taxes ("FUTA") and that the Unemployment Insurance benefit has served many North Carolinians during the economic recovery. The State faces a difficult set of choices. Discussions thus far have identified three options for retiring the debt.

Option 1: The State issues a General Obligation or other bond to pay off the entire debt to the federal government using the future FUTA taxes as a revenue pledge for the bond. I do not believe this is a prudent option for the following reasons.

Issuing a bond would shift the liability from the private sector to the State and runs against our strong history of conservative debt management. I believe that the General Assembly should be very cautious in assuming liabilities on behalf of the State, especially with one that would increase the State's debt burden by 35 percent. Our public finance counsel has also advised that the State would be unable to pledge the FUTA taxes without a referendum.

There have been arguments made that issuing bonds will reduce the amount of interest paid. Estimates about the size and nature of these savings have varied and will continue to vary based on the state of the interest rate environment. There do not appear to be deep savings related to bonding in the short run. There may be greater savings in the long run, but those savings are based on market fluctuations and future rates on the federal borrowing, and are therefore impossible to know with certainty at this time. Estimates of the savings range from approximately $100 million to $200 million over the life of the debt. I do not believe that these potential savings justify taking on the additional liability and departing from our traditional debt management philosophy.

Option 2: Debt is issued to pay off the entire debt to the federal government subject to appropriations from the General Assembly but dedicating the FUTA taxes as a revenue source.

Such an arrangement cannot be considered. Issuing additional state debt at this time would run counter to the State's conservative debt management philosophy, which has been a hallmark of our AAA bond rating. According to this year's Debt Affordability Study, by fiscal year 2014, the State will only have approximately $514 million in available debt capacity assuming a standard twenty-year borrowing structure. The bonding solutions we have reviewed assume a much shorter maturity (between five and 12 years) and therefore would generate an even larger debt service burden.

In the event that future FUTA collections are insufficient to repay the bonds, Department staff believes the market would expect the State to appropriate other funds to support the obligation. We have discussed the proposed structure with the three national bond rating agencies. Only one rating agency believes that we could achieve "self-supporting" status with such an issuance and would therefore be justified in excluding it from the State's debt burden. Of the other two rating agencies, one believed that it would need to be considered as part of the State's debt burden and the other was inconclusive about whether such an arrangement would be counted as an obligation of the State. Based on this disparity of opinion, I believe that any proposed borrowing dedicating the FUTA tax as a bond revenue source must be counted as part of the State's debt load.

Option 3: We maintain the status quo, with private businesses paying the debt directly to the federal government through increases in the FUTA taxes. For the reasons mentioned above, I believe this is the most prudent course of action.

This option provides the same ability to modify benefits as the other scenarios. Similarly, all options provide predictability for businesses.

In future years, I believe that it might make sense to review these options. Depending on the interest rate environment, the State's debt capacity, and economic growth, the analysis could yield a different conclusion at that time.

I, along with Department staff, have worked closely with a number of stakeholders, including the Chamber of Commerce and Employment Security Commission, to identify other solutions for this issue. However, it is my opinion that issuing bonds to pay for the outstanding Unemployment Insurance debt is not the most prudent financial action. I recommend that the General Assembly use great caution in determining whether to proceed with such a borrowing.

Sincerely,

Janet Cowell

Janet Cowell
State Treasurer of North Carolina